

Croda International Plc

Trading update for the period ended 31 May 2023

Call transcript

Key:

Steve Foots – Group Chief Executive

Louisa Burdett – Chief Financial Officer

David Bishop – Director of Investor Relations

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Good morning, everybody. I'm joined in the room this morning by Reece and Steve Foots, CEO, and Louisa Burdett, CFO, is also dialling in. We're recording this call this morning. We'll have some short opening remarks from Steve and then we'll have 40 minutes of Q&A. Over to you, Steve.

Steve Foots – Group Chief Executive

Yeah, thanks. Morning everybody, and thanks for joining the call. It's short notice. Hopefully, you've had a chance to read the trading update that we issued first thing. The two really key points to highlight in terms of what's changed for us since our results at the end of February. Firstly, it's in Consumer Care. Whilst we've been encouraged by the improving performance on quarter four last year and continue to see sequential recovery quarter one to quarter two. The recovery hasn't been as quick as we'd anticipated back in February.

So destocking is ongoing and we now expect that to continue into the second half of the year. And as a result, volumes were down double-digit for the first five months versus the same period last year. The price increases that we introduced last year together with favourable FX have helped to offset that impact. But Consumer Care margins have remained at similar levels to the second half of '22, principally due to this weaker volume we still expect the recovery in Consumer Care to continue throughout the year. We are encouraged with where we are and I'm sure we'll take questions on that, but we'll just be more gradual than we initially thought.

Secondly, in Crop Care, the destocking that we had expected to start later in the year has already begun, and it's been much more rapid than we anticipated. So, we expect that this will now continue until the new planting season at the end quarter three, with some improvements starting to come through during quarter four. Secondly, it's worth noting that Life Sciences margin has been impacted by the adverse mix, including the lower sales of COVID-19 applications in the pharma business, which is all baked in for the second half. Our expectations for the lipid business remains unchanged and is firm now for the second half.

So weaker volumes, largely a result of continued destocking in Consumer Care and earlier than expected destocking in crop, they're the two changes. They've impacted our margins leading to PBT of £143 million for the first five months of the year, supported by the minimal net finance costs. That is lower than plan and as a result, we're revising our overall expectations for the year, and now expect profit before tax to be between £370 and £400 million for the full year.

So macro impact to one side, I continue to be very encouraged by the exciting progress we're making, expanding our innovation pipelines with Croda and as well as giving you further details on our performance, we'll talk a lot more about the scale of our innovation in all of our business areas as we report half-year results in July. Now, Louisa and I are very happy to take questions. Over to your operator to start your Q&A.

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Operator

Thank you. As a reminder, if you'd like to ask a question you can press star followed by one on your telephone keypad. If you'd like to remove your question, you may press star followed by two. Please ensure you're unmuted locally when asking your question. Our first question for today comes from Charles Eden of UBS. Charles, your line is now open. Please go ahead.

Charles Eden – UBS

Hi, good morning. Thank you very much. I'll get myself to two questions. The first one, Steve, you've alluded to it about how things are progressing currently if you could give us an update on the very early trends in June for Consumer Care, are you seeing any recovery at all yet? Then my second question just on the guidance range that you've put out for the full year, could you help us understand what you're baking in in terms of recovery, particularly in Consumer Care, and obviously the margin commentary being first as being similar to the second half of last year. What are you expecting for Consumer Care margins for the full year, please? Thank you.

Steve Foots – Group Chief Executive

Yeah, great. Thanks, Charles. I'll get Louisa to take question two. Just on the Consumer Care progression, it's negative volumes we all saw in quarter four, second half but mainly in quarter four. Volumes have been less negative in quarter one and then less negative again in quarter two. What we track is the invoice say, run rate which is for Consumer Care and that's improving month for month. From a sales point of view, we're broadly flat and actually, we turned positive, just modestly positive in May from a revenue point of view. So we expect that to continue as the comparatives get weaker. The revenue line is pretty robust and the issue really is just this overhead recovery on weaker volumes that you saw in quarter four. That's just continuing. So actually, at the product margin level which I talk a lot about, the product margins records are very robust. They're solid and they have been for several months now. So the issue really is just that weakness in the overhead with the volume which is driving that overhead recovery weakness, which is very unusual in Croda. But when volumes are down low double-digit percentages you do get that. That's what we're living through just until we recover through that. So revenue-wise, pretty robust actually from what we can see.

The other point and then I'll pass to Louisa is, if you look around the business on Consumer Care, it's that weakness in America, which is weak but stable with early signs of improvement and you can see that in the order book. But also you've seen in Europe, which is modestly destocking particularly in France, what we can see in there. But on the other side of things, we've had a good start in China. China is positive for Consumer Care for the first five months, and it's been a really good start there. It's patchy around the edges and fragrance and flavours has had a good start too for the first few months. So it's a mixed bag, but fundamentally revenues holding up well, margins are really down to just this negative volume that's driving that weakness. Louisa, let me let me pass to you on the other point about the assumptions we're making on the range.

Louisa Burdett – Chief Financial Officer

Yeah. Hi, Charles. Good morning, everyone. The question was around what we're baking in for our guidance range of £370 to £400 million. I'll provide some overall comments and we can go to Consumer Care specifics as needed. But in essence, the £370 million is assuming no improvement half on half and it's providing what we believe is a flaw based on annualizing our year-to-date position plus adding the lipids in half two, which we've consistently said would come in quarter four. And that guidance has not changed, as Steve said in his intro. So the £370 million is essentially assuming no improvement in Consumer Care. And then the move up to £400 million Charles, I guess has a couple of layers in there.

There's a layer that is within our control. What I would call implementing sensible self-help cost actions that we can choose to do not damage the business in the medium term whilst we wait for that destocking to come through either but keeping our focus on growth. And then at the higher end of that range of £400 million, it's an assumption that the Consumer Care growth rate half on half increases between 10% and 20%. But essentially the £370 million assumes that we get no improvement for the rest of the year and that the destocking inflexion takes longer to come through that second half. Does that help?

Charles Eden – UBS

Yeah. That's helpful. Thank you. I guess you're assuming if there's no recovery in the Consumer Care in the bottom end of the range effectively what you're saying is the margin at the bottom end for Consumer Care would be around the 19% level that it was in the first and second half of last year and first half of this year.

Louisa Burdett – Chief Financial Officer

Yes. As Steve said, look, we've got double-digit volume declines in the first half of '23. We had double-digit volume declines in the second half of '22 and at the time Jez guided about a couple of points of negative impact on the Consumer Care margin. So we're in that sort of territory. But clearly, if we move up through the range from that base of £370 to £400 million on higher Consumer Care volumes, that will give us some tailwinds behind the margin, but again emphasizing that our £370 million is for the mechanical floor based on no improvements.

Charles Eden – UBS

That's clear. Thank you.

Operator

Thank you. Our next question comes from Matthew Yates of Bank of America. Matthew, your line is now open. Please go ahead.

Matthew Yates – BAML

Hi, Steve, Louisa. Good morning. Steve, you said in your introduction that a double-digit volume decline is highly unusual for a business like Croda. Do you have any market data or feedback from customers that would help us understand how big the disconnect is between your selling to the customer base or the channel and ultimately, what is being sold out, say, somewhat surprising to see your volumes down by this magnitude and for such a long period now? That brings me to my second question as to wondering whether there's a Croda-specific issue here with market share loss. Have you been too aggressive in pricing and especially now that some signs of cost inflation in your raw materials? What's your strategy for trying to retain that and improve your margin versus trying to pass it through to maybe regain some volume to fill up the plants? Thanks.

Steve Foots – Group Chief Executive

Yeah. Good questions, Matthew. Yeah, on the second one, I mean, that's always a question and we spend a lot of time. We all spend a lot of time with our customers. Although last few months just getting up-to-date views and things and the common thing generally is I think it's the multiple stocking, it's mainly the multiple stocking points. We're not losing market share. There's a little bit around the edges, but it really is around the edges to a small degree, and I think what a lot of our customers are saying is, look, the demands holding up pretty well you know the sentiment from them all as you see, like in our innovation programmes, normally you would see things being reduced, paused, stopped innovation projects. We're not seeing that and the other, there's two leading indicators we have in demand that one, and then the second one is around raw materials themselves. They're not coming down, you know they're dropping about 3-4 percent, so that's a good proxy for demand so it looks like demand is solid. Back to your point, we are flexible, particularly in Beauty Care with pricing and yeah, I know one of the long-standing issues is, are we too price hungry at the bottom of the tail of Beauty Care and

are we missing out on volumes. I mean interesting the encouraging growth over the last five or six months, the run rate improvement has been led by Beauty Care, which is really interesting because Beauty Care is more focused on the mass markets, our Beauty Care run rates are increasing quite encouragingly month on month. So that supports volume recovery as well ultimately coming through because that's more the volume and of Consumer Care.

So that's coming through and there's quite a lot of tactical business if you remember one of the issues we had at quarter four was the unplanned outage of a couple of our sites because we didn't take them offline in the heat of the demand periods of the pandemic. From the safety reason we did that going to buy yourself back into some of that business which we're doing and we are doing that now. So actually, the one area of Consumer Care we look much more closely at these days is the Beauty Care area and I'm really pleased with that's coming back. As I said sequentially month on month, I'm encouraged with that. I think your first point Matthew was just reminding me was around any kind of specific issues was in the...

Matthew Yates – BAML

Well, I guess the disconnect maybe if there is a disconnect between sell-in and sell-through, I mean, I struggle to believe that the underlying category is down double digits. So how do you think about that that converging or normalizing?

Steve Foots – Group Chief Executive

Yeah. I've been around many of the conferences this last two or three weeks, we see about eight stocking points for our business I don't know whether that's different to everybody else but when you buy a shampoo or conditioner on the shelf, there's about eight stocking points between there and product shipping and I think the general view from everybody is, you're not losing business. It's all about just this higher stock level that's in the chain somewhere either in six or seven parts to it or three or four of them and the unwind is just taking a bit longer, but we're not far away from positive volumes in Consumer Care. But that's partly because of with comparators, but as we all said the first half can be a bit price skewed and on negative volumes and the second half should reverse and we're seeing a trend play out. It's just that the drag we've got is on those negative volumes, we see that the majority of that is just down to this destocking. We don't see anything else in our intelligence around literally hundreds of data points from big customers to small customers as well. So, I don't know, we're yet to be seeing whether anybody else has got the acute volume issues that that we have but we see that as mainly a just a reset, a correction, a fundamental correction in volumes which is upon us now, and it's a reset. It's a period of reset to rebase demand and stock levels should sort themselves out over the next few months. Louisa, you want to make any other points?

Louisa Burdett – Chief Financial Officer

Only just to reemphasise, I know it was said in the opening statements, but it's been threaded through what you've said Steve, we are down double-digit volumes in the first half, but there has been progressive volume growth over H2, sorry H123 versus H222 of high single digits. So that recess and rebase is not too far from hopefully a volume inflexion point. We know we're starting to see that positive movement on volume.

Matthew Yates – BAML

Thank you both.

Operator

Thank you. Our next question comes from Gunther Zechmann of Bernstein. Your line is now open. Please go ahead.

Gunther Zechmann – Bernstein

Hi, good morning, everyone. Steve, I'd just like to understand a little bit better the weakness in Consumer Carefully. So, you mentioned it's down double digit, but you said China is up five months and you said I think the flavours and fragrance business is doing quite well as well. And you said Beauty Care is doing okay, so what's driving that double-digit weakness? Should we assume that the active and that the beauty effects are down something around 40%? What am I missing here? And then the second question is more on... Yeah, maybe a different question then I've got another question as well, please.

Steve Foots – Group Chief Executive

Yeah, just for clarity and you're looking at there's two different points here one is sequential improvement from quarter one to quarter two and that's what we're seeing through Consumer Care led by Beauty Care so that's one thing. But the other point is there's a year-on-year comparison obviously for the first five months versus five months last year and when you look at that, the first five months of this year versus last year you think of a good growth rate, very good growth rate in F&F. So you know they're in emerging markets more than anything else, so we would expect that to grow.

Beauty Care is still behind last year, but you'd expect that because don't forget there's a massive you know we're comparing apples with pears from last year with a very strong demand half H122 so you're always going to be behind that. But I think the point we're making on Beauty Care is it's improving. Yeah, month on month. I think Actives is mixed, but it's very strong in China, but it's quite weak in France for example, so it's slightly behind but not a huge amount. But again, there you're talking about a very strong comparator with the first five months of last year. So the businesses are all holding up well so overall in the round, our revenue is broadly flat first five months versus last year, but it's driven by your F&F outpacing that of course, Actives and beauty slightly behind, but the volumes are still quite weak and that was the point because it's still quite a lot of in the mix so that's what's helping us and the encouraging sign, as I said, is this Beauty Care, continued improvement which is going to be to volume as well, there as well.

Gunther Zechmann – Bernstein

Okay, that's very helpful and then the second question sort of impossible to answer, but what is your measure of inventory levels at your customers because you've you're not guide for destocking for the remainder of the year? It's something we've been discussing since mid-last year so having a year and a half of destocking, I'd never heard of that so what makes you sure that we're talking about destocking?

Steve Foots – Group Chief Executive

Yes. If you talk about in Consumer Care, what we have to be careful with as an industry issue rather than anything else is the destocking is not homogeneous so it's not the same in every region and a lot of this is it's just it's the pandemic effect where some countries are coming out much earlier than other countries so, for example, America came out of the pandemic first and they sold their way out in the normal American way, and it was a boom period for two and a half years. So in North America, we saw the volumes starting to come off about this time last year late in quarter two and they've continued. I think if you look at North America, you can say that you know there's over-exuberance, there's a lot of stock in the system, but there's probably you can argue there's been some reset of demand as well.

Through that period as well, I think in America, we're very close to a lot of our customers and it's mixed. Some people are replenishing fully now, and some people just go a little bit longer, but it doesn't feel like we're far away. We map every customer's order intake with us, the big customers, and you can start to see that that inflexion is not that far away, but it's just taking a bit longer. So that's North America and in Europe, you've just got a mixed bag. It's not, it's more destocking than demand. We think at the moment and in consumer, pretty robust in

Germany but a bit weaker in France and you know you look at different countries and it's quite difficult to draw consistent factual trends.

But that's what we're seeing there. Asia is pretty resilient and Latin America too so I think the area that we're looking for when destocking has finished is America first because they went into it first, so logically, they would come back first so we could update everybody in the middle of the year. But as I said, we're encouraged with the trend. Sitting above all of this trying to understand all the geography trends, Consumer Care is moving in the right direction.

The other point is crop, you know we expected crop I think our model for the year was sort of moderation by the middle of the year into the second half and then it sort of restarted growth in quarter four at a more normalised level that we would expect, we had a very good start in crop for the first three months, but then literally within a couple of weeks we saw the destocking consistently around our five or six major customers in Europe, North America and Latin America, and that's easier to see because there's a higher concentration of customers there of course so when you look at that trend, that was quite clear and we're an innovation leader, number one in crop and we're in a lot of registered products exclusively so you can very easily map that destocking pretty well and the evidence is it's pretty clear when you talk to your customers so you know our message, the message back is look, they believe they're sitting on three to five to six months of stock but they would replenish as they lead into the planting season later in the year, so that's what we factored into our point on it's a mixed bag across lots of different countries in Consumer Care with lots of different stocking positions for customers but for crop it's much clearer given the higher concentration of customers. If that answers your question.

Gunther Zechmann – Bernstein

Thank you, Steve. That's great. Thank you.

Louisa Burdett – Chief Financial Officer

Steve, it might be worthwhile just continuing that crop trend whilst you've raised it because we haven't spoken about that specifically, but just to build on what Steve said, we saw a very strong Q1 in crop and I think that was touched on in the February communication, but also as Steve said, we've seen quite a big retraction there in the last couple of months and we're expecting that weakness to continue through Q2 and Q3 and clearly that's contributing to our weak half one performance as well as the lack of inflexion in Consumer Care.

But it's also impacting our life science margin because of that timing issue on Q2, but as Steve said, we had best available information with those handful of large customers is indicating that we'll see some level of recovery in Q4. So in terms of absolute profit for Croda, the overall for the full year, we believe will be in balance for crop based on strong Q1 helping to cover the timing issues in Q2 and Q3, but it does give us some short-term margin mix issues in Life Sciences.

Gunther Zechmann – Bernstein

Thank you, Louisa.

Operator

Thank you. So a reminder, if you'd like to ask a question you can press star followed by one on your telephone keypad. Our next question comes from Georgina Fraser of Goldman Sachs. Your line is now open. Please go ahead.

Georgina Fraser – Goldman Sachs

Hi, morning Steve. Morning, Louisa. Thanks for taking my question so my first one is around the demarketing. Now this is something that we've seen Croda do at various points most years, but it historically hasn't had any kind of big impact on margins. I was just wondering how you're

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feeling about the demarketing activities you undertook last year in light of the destocking cycle? Has it exacerbated the losses that you've had on the volume side and is it making it more difficult to regain market share? Is it going to lead to lower prices and so that's the first question. And then the second question is, since we have now seen destocking in two of the three legs of Croda how are you thinking about the risk of normalising demand in the healthcare supply chain? Thanks.

Steve Foots – Group Chief Executive

Yeah, correct. I mean on the demarketing, the normal demarketing for Croda through a normalized cycle but of course, we had the unplanned outages, which was sort of forced demarketing, which we didn't really want to do for quarter four. Clearly, what happens there is, we try and go back in and we have a very focused plan to go back in with price moderation where needed to try and recover that business but that never comes back overnight but it's mainly in Beauty Care is what we're targeting. We can start to map that coming through but evidence of Beauty Care coming back more strongly first is probably with two things.

It's recovery in the mass market, but there's also some tactical business starting to come back in. So that will drip in over the next few months, but clearly given the negative volumes, it's not lost on us that sacrificing for a bit of price to recover some volume is a good decision for us to make sure we get those volumes back up so there's probably a more focused view of that given the overhead issues that you can get in a sort of one in the 15-year event that we're living through. So we're targeted, we have very structured approaches to that from all around the world and we're monitoring that. So it's starting to come back, but it's more weighted to the second half because inevitably it just takes a little bit longer for some of that to come back.

I think on your Pharma point, yeah, I'm picking that up from a lot of people that quite a number of our peers are talking about destocking there, it's around the edges for us. We haven't really called that out in the release because it is around the edges and because we're in privileged growth areas, I think most of our pharma activity is in those three categories. They're all growing so that they're in the growth in businesses is actually outweighing any sort of fringe destocking around the edges. So we're not, it's not material issue in the numbers around that. Louisa, do you want to add?

Louisa Burdett – Chief Financial Officer

Steve, I think we've made this clear through various interactions with the markets since February, but just we've talked about sort of necessary demarketing from not having enough capacity to support demand in the immediate exit from COVID and then the regrettable demarketing because of our plants being out. But just to reemphasize these points that the plants are all back up and running and that regrettable remarketing piece is no longer in the mix which is brilliant but nothing else to add to see.

Georgina Fraser – Goldman Sachs

Thank you both.

Operator

Thank you. Our next question comes from Nicola Tang of BNP Paribas. Your line is now open. Please go ahead.

Nicola Tang – BNP Paribas

Thanks, and hi everyone. And the first question was on margins in Life Sciences, and I think you were already flagging that you'd have this worsening mix because of crop versus healthcare so I was wondering if you could talk a little bit more about if this is incrementally that much worse. I think you were previously guiding or steering towards low 30s margin in Life Sciences, so does that still hold? And then the second question, Louisa, in one of the

answers to the questions, I think you mentioned sort of sensible self-help I was wondering if you could just, I guess, talk a little bit about more about what that is? Thanks.

Steve Foots – Group Chief Executive

Okay, great. Louisa, do you want to take them both? And then I'll chip in.

Louisa Burdett – Chief Financial Officer

Yeah. Look, Nicola on the margins for Life Sciences, you're correct. We guided to just over 30% return on sales in that portfolio and we are going to see that slightly lower at the first half year, just because of some of the trends that we've been talking about today with lower COVID-19-related sales from our principal partner and that destocking in crop, we've seen pricing come off in sort of mid-single digits. So we will be seeing something in the probably mid 25 in the half year for Life Sciences. So yes, below our previous guide on that.

On sensible self-help, look, there's a balance to be struck here we have, as Steve said, a lot of really exciting innovation projects. We've got a lot of capital and other projects going on to support growth in the business for the medium and long term and we won't be compromising those. This will be the normal reaction that you would expect from a company managing some sort of short-term trading weakness, discretionary spend prioritizing the commercial and front end of the business and just looking at the timing of certain projects and investments to optimize what the teams are working on.

Just while I have the floor, related to sort of spending and operation expense. We haven't mentioned any cash position in our communication this morning and I just like to take the opportunity to briefly mention that clearly with the drop in EBIT our cash, our absolute cash delivery this year will be affected but we are going to continue to invest in our capital programmes. We've talked very clearly about the investment that needs to go into pharma to support the LNP growth, but we will have some impact on cash flows because of these bits are dropped but we will hopefully have a little bit of working capital, positive unwind as our stocks drawdown, but to get back Nicola to your question, margins in Life Sciences, we'll be below the guidance that we gave in February for the half year and our sustainable self-help is really about sensible choices about where we're putting our cash as we go through this in stocking cycle.

Nicola Tang – BNP Paribas

All right, thanks. Anyway, I may just follow up or just clarify those on life science margins is it's mid-25 in H1, assuming sort of the timing of Pfizer, there is still some sequential improvement or could it be that there's a risk that there's nothing changes? That actually we're looking at that kind of level for the year?

Louisa Burdett – Chief Financial Officer

Sorry Nicola, I didn't make that clear. No, we've obviously got the Pfizer shipments in the second half of the year, which as we indicated upfront guidance hasn't changed and Steve made the reference that those are committed, and we will see sequential margin improvement in the second half off the back of that.

Nicola Tang – BNP Paribas

Thank you.

Operator

Thank you. We currently have no further questions for today. So that concludes today's conference call. Thank you all for joining. You may now disconnect your lines.

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